

Message Text

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ACTION EB-11

INFO OCT-01 EUR-25 ISO-00 SP-03 AID-20 NSC-07 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 SAJ-01

CIAE-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

SIL-01 L-03 H-03 PRS-01 PA-04 USIA-15 FEAE-00 AGR-20

INT-08 SCI-06 AEC-11 DRC-01 /212 W

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P R 211734Z JUN 74

FM AMEMBASSY PARIS

TO USDOC WASHDC PRIORITY

INFO SECSTATE WASHDC 0179

UNCLAS SECTION 01 OF 02 AMEMBASSY PARIS 15182

COMMERCE FOR OIM/WE

E.O. 11652: N/A

TAGS: EFIN, FR

SUBJECT: CURRENT FRENCH ECONOMIC SITUATION

1. SUMMARY. THE FRENCH ECONOMY TODAY IS CHARACTERIZED BY INFLATION (CURRENTLY AT AN ANNUAL RATE OF 16-20 PERCENT) AND A SERIOUS DEFICIT IN THE BALANCE OF TRADE (NOW ESTIMATED AT BETWEEN \$5 AND \$6 BILLION THIS YEAR). A PROJECTED 1974 REAL GROWTH RATE OF CLOSE TO FIVE PERCENT, WITH PRODUCTION AT CAPACITY IN MANY SECTORS, PROVIDES DEMAND PRESSURES WHICH THE NEW GOVERNMENT'S AUSTERITY PROGRAM IS DESIGNED TO REDUCE. WERE IT TO SUCCEED FULLY, INFLATION WOULD BE CUT TO A TWELVE PERCENT ANNUAL RATE THIS YEAR (SIX PERCENT BY MID-1975) AND TRADE EQUILIBRIUM RESTORED BY THE END OF NEXT YEAR. END SUMMARY.

2. INFLATION IN FRANCE HAS CONTINUED TO WORSEN. WAGE INCREASES IN THE FIRST QUARTER ADVANCED AT AN ANNUAL

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RATE OF MORE THAN 20 PERCENT. IN 1973, THE MONEY SUPPLY

HAD INCREASED BY ALMOST 15 PERCENT, INSTEAD OF PLANNED GOAL OF 12, AND THIS YEAR A BANK STRIKE AND THE POLITICAL "INTERREGNUM" FOLLOWING DEATH OF PRESIDENT POMPIDOU HAVE PERMITTED CONTINUED BREACHES IN THE BARRIERS TO CREDIT EXPANSION THE GOVERNMENT HAD SET UP IN 1973. AT THE SAME TIME, THE FEARED EFFECTS OF THE OIL CRISIS ON THE ECONOMY HAVE NOT MATERIALIZED AND FRENCH INDUSTRY IS STILL OPERATING AT CAPACITY IN MANY SECTORS. A STRONG DEMAND PUSH THEREFORE CONTINUES AS MAJOR FACTOR FEEDING INFLATION, WHICH IS RUNNING AT A RATE OF SOME 16-20 PERCENT THIS YEAR.

3. IF THE INTERNAL ECONOMY WAS SPARED A RECESSION, FRANCE'S TRADE BALANCE HAS BEEN AFFECTED CONSIDERABLY MORE SEVERELY BY THE OIL CRISIS THAN WAS ORIGINALLY ASSUMED. WHILE FRENCH EXPORTS HAVE INCREASED MORE RAPIDLY THAN IMPORTS, BY VOLUME, HIGHER PRICES OF PETROLEUM AS WELL AS OTHER PRIMARY PRODUCTS, AND EQUIPMENT GOODS, HAVE SO WORSENERED THE TERMS OF FRENCH TRADE THAT A SUBSTANTIALLY INCREASING DEFICIT HAS BEEN RECORDED ON ALL BUT ONE MONTH OF THIS YEAR. THIS DEFICIT HAS REACHED THE EQUIVALENT OF OVER \$600 MILLION ON A SEASONALLY ADJUSTED BASIS IN MAY ALONE. ORIGINAL ESTIMATES OF A 1974 TRADE DEFICIT OF ABOUT \$4 BILLION HAVE NOW GIVEN WAY TO PREDICTIONS RANGING FROM \$5 TO 6 BILLION. FRANCE HAS HAD TO BORROW SOME \$3.5 BILLION TO HELP MEET THE DEFICIT.

4. ON JUNE 12, THE NEW GOVERNMENT OF PRESIDENT VALERY GISCARD D'ESTAING ANNOUNCED A SERIES OF MEASURES TO ATTACK THESE TWO MAJOR PROBLEMS, PRINCIPALLY THROUGH MEASURES DESIGNED TO CUT DOMESTIC DEMAND FOR BOTH PRODUCER AND CONSUMER GOODS. SURCHARGES ARE TO BE LEVIED ON BOTH CORPORATE PROFITS TAXES AND PERSONAL INCOME TAXES IN THE HIGHER BRACKETS (WITH FULL OR PARTIAL REIMBURSEMENT OF THE LATTER NEXT YEAR), AND ANTI-FRAUD MEASURES STRENGTHENED. DEPRECIATION ALLOWANCES ARE TO BE CUT ON NEW INVESTMENTS FOR ONE YEAR BEGINNING JULY 1, AND A NEW TAX ON PROFITS "DERIVING FROM INFLATION" IS TO BE ELABORATED. THE UNCLASSIFIED

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"INFLATIONARY BONUS" TO GOVERNMENT REVENUE WILL BE STERILIZED, AND EXPENDITURES CUT. LIMITS ON THE GROWTH OF CREDIT WILL BE STRICTLY ENFORCED AND SAVINGS WILL BE ENCOURAGED THROUGH AN INCREASE IN INTEREST RATES. EXISTING CONTROLS ON PRICES WILL BE STRENGTHENED. TO HELP CUT PETROLEUM IMPORTS, PRICES ON ALL FORMS OF ENERGY WILL BE ALLOWED TO RISE AT AN AVERAGE OF FIVE PERCENT (WITH GASOLINE RISING TO ABOUT \$L.40 PER

U.S. GALLON), AND MOST IMPORTANT, CONSUMPTION OF HEATING FUEL WILL BE RESTRICTED, SO THAT INDUSTRIAL IMPORTS NEED NOT BE AFFECTED.

5. WHILE THE NEW PROGRAM CLEARLY ADMITS THAT THE PROBLEM OF INFLATION WILL REMAIN WELL INTO NEXT YEAR, RATHER THAN BEING SOLVED BY MID-1974 AS PREVIOUS ECONOMIC PROGRAMS HAD PREDICATED, ITS GOALS APPEAR

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QUITE AMBITIOUS. THE ANNUAL INFLATION RATE IS TO BE CUT TO 12 PERCENT BY THE END OF THIS YEAR AND 6 PERCENT BY MID-1975, WITH FRANCE'S TRADE TO BE IN BALANCE BY THE END OF NEXT YEAR. AT THE SAME TIME, THE GOVERNMENT PROJECTS A RATE OF REAL GROWTH IN 1974 OF CLOSE TO FIVE PERCENT, WHICH IS REGARDED AS NEEDED TO ABSORB YOUNG PEOPLE ENTERING THE LABOR FORCE. IT HAS ALSO PROPOSED A PROGRAM OF SOCIAL WELFARE MEASURES WHICH ARE EXPECTED TO ADD SOME 2.5 BILLION FRANCS TO

THE PURCHASING POWER OF LOWER INCOME GROUPS. HERETOFORE, THE GOVERNMENT'S ANTI-INFLATIONARY MEASURES HAVE CONFLICTED WITH, AND EVENTUALLY YIELDED TO, ITS SOCIAL CONCERNS, PARTICULARLY THAT OF ASSURING FULL EMPLOYMENT. THE PRESENT ANTI-INFLATIONARY MEASURES ARE STRONGER IN SEVERAL REGARDS, AND MAY PROVE MORE EFFECTIVE.

6. THE MOST DIRECT SIGNIFICANCE OF THE NEW PROGRAM FOR U.S. INTERESTS IS THAT THE GOVERNMENT SPECIFICALLY UNCLASSIFIED

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CONFIRMED ITS PLEDGE TO ESCHEW PROTECTIONIST MEASURES IN ITS EFFORTS TO IMPROVE FRANCE'S TRADE BALANCE. OF COURSE, THE OBJECT OF THE NEW PROGRAM IS TO DAMPEN DEMAND, AND THIS INCLUDES DEMAND FOR IMPORTS.

7. IN CONSEQUENCE, WE PROBABLY MUST ANTICIPATE SOME EFFECTS ON SALES OF U.S. PRODUCTS TO FRANCE AND-- IN VIEW OF TEMPORARY REDUCTION OF THE DEPRECIATION ALLOWANCE-- ESPECIALLY EQUIPMENT GOODS. NONETHELESS, THE ENERGY CRISIS WILL PROBABLY MEAN THAT THE MASSIVE NUCLEAR ENERGY PROGRAM, WITH ITS GOOD PROSPECTS FOR AMERICAN PARTICIPATION, WILL CONTINUE AS PLANNED. WE ARE ALSO OPTIMISTIC ABOUT ENERGY-CONSERVING INSULATION MATERIAL FOR THE BUILDING INDUSTRY, WATER POLLUTION CONTROL EQUIPMENT AND INSTRUMENTATION, COMMERCIAL AND INDUSTRIAL SECURITY EQUIPMENT, AVIONICS AND AIRFIELD EQUIPMENT, ADVANCED MEDICAL EQUIPMENT, ELECTRONIC COMPONENTS AND CONSUMER GOODS SUCH AS LADIES' AND CHILDRENS' APPAREL AND "DO-IT-YOURSELF" TOOLS AND SUPPLIES.

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